LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7688 **NOTE PREPARED:** Jan 6, 2005
BILL NUMBER: HB 1498 **BILL AMENDED:**

SUBJECT: Tax credit for new employee wages.

FIRST AUTHOR: Rep. Buck **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State
X **DEDICATED**
FEDERAL

Summary of Legislation: The bill provides a state tax credit for wages paid to a new employee employed after December 31, 2005.

Effective Date: January 1, 2006.

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this credit. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Explanation of State Revenues: *Summary:* The bill could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, Insurance Premiums Tax, and Financial Institutions Tax by as much as $17.9 M to $31.0 M in FY 2006 and $73.8 M to $128.0 M in FY 2007. However, the revenue loss could potentially be much less to the extent that businesses qualifying for credits have insufficient tax liabilities to use the credit amounts, as credits are not refundable and must be used in the year they are earned. The fiscal impact in FY 2006 assumes that taxpayers adjust their quarterly estimated payments.

Background: The bill provides a tax credit against AGI Tax, Insurance Premiums Tax, and Financial Institutions Tax liabilities of individual and corporate taxpayers that have full-time employees who qualify as a "new employee under the bill (see definition below). The credit is equal to the lesser of: (1) 5% of the compensation paid by the taxpayer to new employees during the taxable year or (2) 0.5% of the taxpayer's combined tax liability from the AGI Tax, the Insurance Premiums Tax, and the Financial Institutions Tax in the taxable year. The bill also provides for bonus credits ranging from 1% in tax year 2006 to 0.25% in 2009 if the taxpayer adds 50 or more jobs during the taxable year. The taxpayer may claim the credit each year the taxpayer either employs: (1) the new employee or (2) the new employee's successor, provided the new employee was promoted by the taxpayer to another job.

The net revenue impact of this credit depends on the extent that tax collections from new employees are less than or exceed the amount of credits claimed by the business. However, if the employees would have been hired in the absence of the tax credit, the net impact would be the total credits claimed by the business. The table below reports the total annual credits that could potentially be *earned* by taxpayers, and the amounts attributable to underlying growth in jobs that is unrelated to the tax credit and to job growth induced by the tax credit. It is estimated that the annual credit amounts could potentially increase at about 4.7% to 5.5% beginning in FY 2011. The amount of credits earned each year by taxpayers could potentially be greater than reported in the table if bonus credits above the minimum 5% credit level are earned. In addition, credits earned by taxpayers likely will be greater than reported in the table since the estimates are based on employment totals reflecting net change in employment (gross job gains minus gross job losses) and not gross jobs created. However, the actual revenue loss from the credit depends on the tax liabilities of taxpayers earning credits. Thus, the revenue loss could potentially be significantly less than the amount of credits earned to the extent that tax liabilities are insufficient to actually use the credits.

	Estimated Revenue Loss (millions)		
Fiscal Year	**Due to Underlying Employment Growth**	**Due to Induced Employment Growth**	**Total**
2006	$17.5 - $30.5	$0.4 - $0.5	$17.9 - $31.0
2007	72.0 - 126.1	1.8 - 1.9	73.8 - 128.0
2008	149.1 - 261.9	3.8 - 3.9	152.9 - 265.7
2009	232.4 - 409.7	5.9 - 6.1	238.3 - 415.8
2010	282.1 - 500.2	7.2 - 7.4	289.3 - 507.6
2011	295.4 - 527.9	7.5 - 7.8	302.9 - 535.7

The fiscal impact from underlying employment growth is estimated based on: (1) current private employment levels and long-run employment growth rates in Indiana; (2) current average compensation levels (wages plus fringe benefits) in Indiana; and (3) the long-run growth rate in average compensation in Indiana. The fiscal impact from employment growth induced by the tax credit is based on: (1) estimates of the average percentage increase in demand for labor given a 1% reduction in the average wage; and (2) current employment and average compensation levels statewide. Both sets of estimates assume employee job tenure of 4 years.

The tax credit may not be claimed for an employee if the taxpayer claims either an EDGE Credit or the Enterprise Zone Employment Cost Credit for the employee. The tax credit is nonrefundable and may not be carried forward or carried back. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. A "new employee is defined as an employee working at least 35 hours per week; who was first employed in Indiana by the taxpayer after December 31, 2005; and who is not an "excluded employee. An "excluded employee is defined as an employee: (1) who performs a job that was previously performed by another employee in Indiana, if the job existed for at least 6 months before hiring the new employee and the preceding employee was not promoted to another job; (2) who was previously employed in Indiana by a related member (person or entity with an ownership interest in the taxpayer) and whose employment was transferred to the taxpayer after January 1, 2006; or (3) who is a relative of the employer or an employee, and has at least a 5% ownership interest in the taxpayer.

Revenue from the corporate AGI Tax, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. The revenue from the individual AGI Tax is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%). Since the tax credit is effective beginning tax year 2006, the fiscal impact could potentially begin in FY 2006 if taxpayers adjust their quarterly estimated payments.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue.

Local Agencies Affected:

Information Sources: U.S. Bureau of Labor Statistics (BLS), www.bls.gov. BLS, *State and Area Employment, Hours, and Earnings*. BLS, Quarterly Census of Employment and Wages. BLS, Employer Costs for Employee Compensation. BLS, *Employee Tenure in 2002.* BLS, *Business Employment Dynamics Data.* BLS, Daniel E. Hecker, Occupational Employment Projections to 2010, November 2001. Sarah Lowe, *Indiana Enterprise Zone Program: Employment and Fiscal Impact Analysis of a Job Creation Tax Credit*, Thesis, Purdue University, 2004. Kim Clark & Richard Freeman, "How Elastic is the Demand for Labor? *The Review of Economics and Statistics*, 1980.

Fiscal Analyst: Jim Landers, 317-232-9869.